REPORT OF EXAMINATION

WASHINGTON CASUALTY COMPANY

As of December 31, 1996

Prepared for the Washington State Insurance Commissioner's Office by Examiners; Frank S. Ebreo, AFE, FLMI, John R. Jacobson, AFE and EDP Specialist, Larry A. Omdal, Examiner in Charge and Timoteo L. Navaja, CFE and Field Coordinator. Actuary Jim Antush, and Chief Property/Casualty Actuary D. Lee Barclay, FCAS
810 Third Avenue, Suite 650
Seattle, WA 98104

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify that the attached Report of Examination shows the financial condition and affairs of WASHINGTON CASUALTY COMPANY of Bellevue, Washington, as of December 31, 1996.

JAMES T. ODIORNE, CPA, JD
Acting Chief Examiner

9/25/1998
(Date)

WASHINGTON CASUALTY COMPANY

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Seattle, Washington
September 1, 1998

The Honorable George M. Reider, Jr.
Commissioner, State of Connecticut Insurance Dept.
Chairman, NAIC Financial Condition (EX-4) Sub-Committee
P.O. Box 816
Hartford, Connecticut 06142-0816

The Honorable Christopher P. Krahling
Superintendent of Insurance, State of New Mexico
NAIC Secretary, Western Zone
P.O. Drawer 1269
Santa Fe, New Mexico 87504-1269

The Honorable Deborah Senn
Commissioner, Washington Insurance Department
Insurance Building, AQ-21
Olympia, WA 98504-0255

Dear Commissioners:

In accordance with your instructions and in compliance with statutory requirements of the State of Washington (RCW 48.03), an Association Examination has been made of the corporate affairs and financial records of the

WASHINGTON CASUALTY COMPANY
of
Bellevue, Washington

hereinafter referred to as the Company. The examination was performed at its administrative office located at 14100 SE 36th Street, Bellevue, Washington 98006-1568. This report of examination is respectfully submitted showing the condition of the Company as of December 31, 1996.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1991. The current examination was conducted by insurance examiners from the State of Washington and covers the period from January 1, 1992 through December 31, 1996. The examination was conducted in accordance with the laws and regulations of the State of Washington contained in Title 48 of the Revised Code of Washington and Title 284 of the Washington Administrative Code and the examination procedures recommended by the National Association of Insurance Commissioners found in the NAIC Financial Condition Examiner's Handbook.

Corporate records and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. The Company’s Certified Public Accountant’s work papers were reviewed and utilized where possible to support efficiency in the examination.

Comments on any adverse findings which are applicable to the current examination are included in the Instructions and the Comments and Recommendations sections of this report.

As part of our examination, we also reviewed the following areas:

Conflict of Interest Policy
Fidelity Bonds and Other Insurance
Corporate Records
Employee Benefit Plans

INSTRUCTIONS

The examination process detected no violations of Regulation or Law that require instructions to the Company.

COMMENTS AND RECOMMENDATIONS

Pursuant to the findings and conclusions of the examiners, it is recommended:

1. **IT IS RECOMMENDED** that the Corporate Bylaws, Article I, Section 1, be amended to specifically state the current principal place of business rather than reference the Articles of Incorporation which states the initial place of business.

2. **IT IS RECOMMENDED** that the securities custodial agreement be updated to include provisions for indemnifying the Company for the loss of securities as recommended by the NAIC.

3. **IT IS RECOMMENDED** that the Company revise and enhance its Disaster Recovery Plan to include appropriate escalation procedures to resolve operational failures in a timely manner, as recommended in the NAIC Guidelines. Currently, the plan only addresses equipment breakdown and restoring data from back up tapes. The plan needs to include procedures for large scale disasters, such as fire or other loss of office facilities.

4. **IT IS RECOMMENDED** that the Company prepare a Business Contingency Plan that addresses the continuation of all significant business activities, including financial functions, telecommunications services and data processing services, in the event of a disruption of normal business activities, as recommended in the NAIC Guidelines.

Recommendations 3 and 4 relate to **RCW 48.07.160 - Continuing operation in event of national emergency...**, which contains a very broad general requirement to cover a very narrow specific circumstance. It is our belief that the Legislature's intent to protect policyholders, etc., extends to more than just foreign attack on the United States, but actually extends to natural disasters. The NAIC guidelines address the perceived broader legislative intent.

HISTORY

Washington Hospital Insurance Fund (WHIF) was established in 1977 by the Washington State Legislature to provide a professional liability insurance market for Washington hospitals. WHIF changed its name to Northwest Healthcare Insurance Services (NHIS) on April 20, 1995.

Washington Casualty Company was incorporated on June 21, 1990, as a stock company under the laws of the State of Washington. It is a wholly owned subsidiary of Northwest Healthcare Insurance Services (NHIS).

The parent filed an Insurance Holding Company System Registration Statement in July 1990. WCC obtained its certificates of authority to transact property and casualty insurance business in the States of Washington, Oregon and Idaho. On October 1, 1990, WCC assumed the contractual obligations of WHIF policies through an assumption certificate.

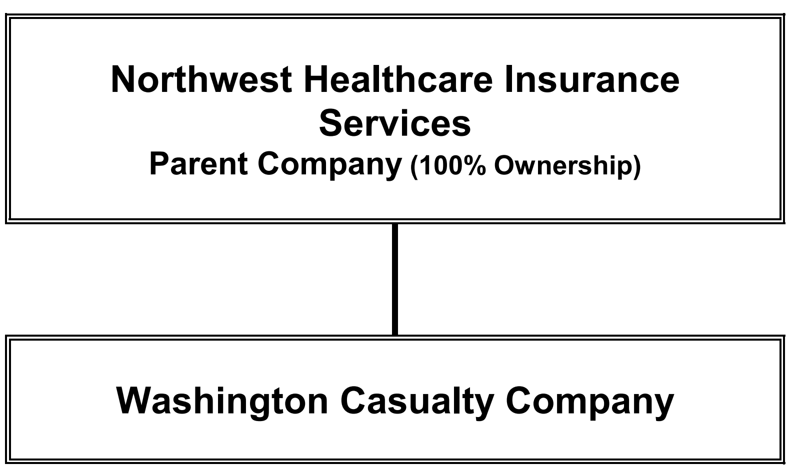
On December 31, 1991, the Board of Directors of the Company and its parent approved the transfer of all claims made business from the parent company to the Company. As a result, loss and loss adjustment expense reserves of $19,108,000, net of ceded reserves of $1,887,000, for medical malpractice losses reported from July, 1, 1985 to September 30, 1990 were assumed by the Company. The transfer resulted in no gain or loss and included class one-rated bonds.

On December 31, 1996, all remaining occurrence made business of ($670,000) was transferred from the parent company to the Company. This business was written between 1977 and 1985. No gain or loss was reported on the transfer. Class one-rated bonds supported the reserve assumption.

CAPITALIZATION:

Northwest Healthcare Insurance Services (NHIS) purchased all of the authorized common stock of 150,000 shares at $10 par value on May 17, 1990. The parent company also contributed an additional $5,500,000 as paid-in capital at that time.

The following organizational chart displays the relationship of Northwest Healthcare Insurance Services to the Washington Casualty Company.



MANAGEMENT and CONTROL

BOARD OF DIRECTORS:

Control of the Company is vested in the Board of Directors consisting of 12 members. Mark D. Judy, a former Board member, was appointed to the Board during 1996 due to termination of the President and CEO. Directors serving the Company at December 31, 1996:

Name and Address	Principal Business Affiliation	Residence
David K. Hamry –Chair	Pres. Good Samaritan Community Hlth Care	Puyallup, WA
Ausey H. Robnett	Medical Doctor	Spokane, WA
Robert L. Zylstra	Administrator Whidbey General Hospital	Oak Harbor, WA
Richard W. Linneweh	Pres./CEO Yakima Valley Memorial Hospital	Yakima, WA
Joan Soriano	none	Bremerton, WA
James K. Anderson	none	Redmond, WA
Patrick R. Mahoney	Admin/CEO Affiliated Health Services	Mount Vernon, WA
Duane H. Thompson	none	Kingston, WA
Suzanne F. Lile	none	Bellevue, WA
Juan C. Olivares	Exec. Dir. Yakima Valley Farm Workers Clinic	Yakima, WA
George A. Wade	Pacific Capital Corporation	Seattle, WA
Mark D. Judy	President and CEO, WCC (Interim appointment)	Snohomish, WA

OFFICERS:

Officers on December 31, 1996 were:

Mark D. Judy	President and Chief Executive Officer (interim appointment)
Deborah K. Samples	Vice President, Underwriting & Marketing
Douglas D. Wisman	Chief Financial Officer, VP Financial Services
Ronald D. Hall	Vice President, Claims
Sharon L. Hall	Vice President, Risk Management
Leslie Barnette, M.D.	Vice President and Medical Director
Mary L. Pearrow	Corporate Secretary

COMMITTEES:

Committees of the Board of Directors are as follows:

Executive Committee
Finance/Investment Committee
Audit Committee
Nominating Committee
Strategic Planning Committee

CORPORATE RECORDS:

The Articles of Incorporation are in the original form as filed June 21, 1990. The Corporate Bylaws were amended and rewritten April 7, 1995.

Article I - Offices, Section 1 - Principal Office, of the Corporate Bylaws states that, "The principal office of the Company shall be located at such place as indicated in the Articles of Incorporation." Article VII - Principal Place of Business, of the Articles of Incorporation makes reference to the "initial address" of the Company. There is no reference to the "current principal place of business." (See Comments and Recommendations 1)

The annual meeting of the shareholder is held in the month of April in each year. At that meeting, the stockholders elect a Board of Directors and transact such other business as may properly be brought before the meeting. Generally, Board of Director meetings are held four times a year.

It appears the Company keeps a correct and complete set of books and records of account and minutes of the proceedings of its' Stockholders, Board of Directors and Committees of the Board. Books, records, and minutes are in written form and were reviewed during the course of the examination. Meetings were well attended and the minutes were in sufficient detail and substance to demonstrate that the Board was actively involved in the administration of the affairs of the Company.

INTERNAL SECURITY

Conflict of Interest:.

The Company has an operating procedure for disclosing possible conflicts of interest to the Board of Directors. A Conflict of Interest Questionnaire is furnished annually to officers, directors, and all other employees to be completed and submitted to the Board for review. Our review disclosed no adverse findings in this area.

Fidelity Bond and Other Insurance:

The Company is a named insured under a financial institution bond. The coverage exceeds the minimum amount of fidelity insurance suggested by the NAIC.

The Company also is a named insured on other insurance policies covering the hazards to which the Company is exposed. Some of these coverages include: General Liability, Property, Inland Marine, Business Automobile, Umbrella Liability, Workers' Compensation, Fiduciary Liability, Directors & Officers Liability, Errors & Omissions, Professional Liability and Employment Practices.

INTERNAL SECURITY (Continued)

Information Systems:

Company management is sufficiently knowledgeable of EDP issues and provides direction and oversight through the Steering Committee. Systems Development, Acquisition and Maintenance Controls were evaluated to gain assurance that programs and systems are designed, tested, approved and implemented using appropriate controls. Due to the small size of the Company, there are numerous areas where separation of duties is not possible. In those instances, the Company has increased the review and oversight by management.

The Company does not have any EDP employees on staff. An outside vendor has been hired to operate and maintain its EDP equipment and system operations. A three year contract is currently in effect which identifies the responsibilities and the services to be provided by the vendor.

Operations and Application Controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed and the controls exercised to maintain data security. Adequate procedures and controls are in place for network operations, PC's and year 2000 issues. The Company is on schedule for becoming year 2000 compliant by year end 1998.

The Company's Disaster Recovery Plan does not include appropriate escalation procedures to resolve operational failures in a timely manner. The current plan only addresses equipment breakdown and restoring data from back up tapes. The plan does not include any procedures for large scale disasters, such as fire or other loss of office facilities. (See Comments and Recommendations 3)

The Company does not have a Business Contingency Plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities. (See Comments and Recommendations 4)

EMPLOYEES' BENEFIT PLANS

The Company administers a defined contribution plan and a 401(k) plan. The Company contributes an amount equal to 4% of each employee's annual salary to the defined contribution plan and matches 50% of an employee's contributions, not to exceed 4% of the employee's annual salary, into the 401(k) plan. The plans are funded on a monthly basis

The Company's Board of Trustees has approved an incentive compensation plan (ICP). Employees are eligible for participation in the ICP if they have nine months of service during the year and are employed on the first day of the month in which an incentive award is determined. Amounts are paid 100% in the year following the award. If the Company earns the maximum ICP award in a given year, an additional 4% of salary is contributed into each eligible employee's 401(k) plan. There was no ICP expense incurred in 1996.

The Company also maintains a deferred compensation plan for members of its Board of Directors. The plan allows individual Board members to defer the payment of Board fees until such time that they are no longer a member of the Board of Directors.

TERRITORY AND PLAN OF OPERATION

As of December 31, 1996, the Company was authorized to transact property and casualty business in the States of Washington, Oregon, and Idaho under certificates of authority obtained in July 1990, May 1991, and December 19, 1994, respectively.

The Company does not have immediate plans to expand into other states or other lines of business.

The Company's mission is to provide primary and excess insurance coverage in the professional and general liability area for hospitals and physicians. Its products are marketed through company appointed agents.

REINSURANCE PROGRAM

The Company has entered into reinsurance agreements with several reinsurers (placed with London syndicates/companies and Employers Reinsurance Corporation (ERC)) to provide reinsurance coverage for hospitals and non-physician groups in excess of the first $500,000 loss per occurrence up to the Company's policy limit of $2,000,000, subject to an aggregate amount of 300% of the maximum reinsurance premium for the last three-year period. All losses in excess of $2,000,000 are 100% reinsured, including clash coverage for the first $6,000,000 of excess coverage above the Company’s retention of $500,000. The Company's non-physician reinsurance premium is retrospectively determined based on 110% of ceded claims experience subject to a predetermined maximum. Initial premium estimates are determined and then continually reviewed and adjusted as necessary; such adjustments are reflected in current operations.

ERC reinsures all of the physicians’ and surgeons’ business written by the Company for losses in excess of $250,000 per occurrence up to $4,750,000, with an annual aggregate of $14,750,000 per policy.

The Company remains obligated for amounts ceded in the event that reinsurers do not meet their obligations. No reinsurance amounts are assumed.

The Company’s credit for reinsurance is in accordance with statutory limitations pursuant to RCW 48.12.160.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounts and records on electronic data processing equipment owned by the parent company. The general ledger is maintained using IBM Platinum accounting software with features to provide for direct posting to the general ledger from subsidiary records. The claims database is maintained using Foxpro software.

The accounting records, including the general ledger and subsidiary records, are maintained on a GAAP basis. Statutory Statement balances are reconciled to the general ledger. Reconciling items consist of prepaid expenses, deferred acquisition costs, and FAS 115 investment reporting differences.

Securities are deposited with U.S. Bank under a custodial agreement. The current custodial agreements do not include wording to provide for indemnifying the Company for the loss of securities as recommended by the NAIC (See Comments and Recommendations 2) . The bank provided monthly statements of investment transactions, including interest earned and gains or losses on dispositions.

Underwriting:
The Company writes medical malpractice and general liability insurance to health care facilities and providers for a one-year term. All policies issued during the examination period were on an annual basis and are recalculated and adjusted every 12 months. Because of the nature of the business underwritten, the Company places heavy emphasis on risk management.

All premiums are calculated on a pro-rata basis and are recalculated as needed for all amendments, adjustments, and cancellations. Different types of coverage are provided for health care facilities and providers with specific identification of each.

Claims Settlement:
The Company has written procedures covering the handling and settlement of claims. A review of a sample of closed claims from October 1, 1991 through March 31, 1992, indicated that claims were settled in accordance with policy provisions and established Company procedures. Since inception of the Company, only one complaint has been received, as it was ultimately determined to have no merit.

UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

These reserves were reviewed by the casualty actuarial staff employed by the Insurance Commissioner's Office. The Company's consulting actuarial firm, Coopers & Lybrand L.L.P., provided loss and loss adjustment expense development data by line of business. OIC actuarial staff obtained additional information by interviewing several Company employees. They also reviewed actuarial reports prepared by Coopers & Lybrand L.L.P.

The OIC actuarial staff's estimates indicate that reserves for losses and loss adjustment expenses, on a net basis, are within a reasonable range. Therefore, these reserves are accepted as they appear in the Company's 1996 Annual Statement.

SUBSEQUENT EVENTS

In May of 1997, the Company hired a new President, Mr. Preston B. (P.J.) Livingston. He has significant industry experience and was most recently a senior officer with a medical malpractice company domiciled in California.

The Company changed its independent certified public accountants in July 1997. Deloitte & Touche LLP will conduct the annual audit effective for the year 1997.

In January of 1998, the Company appointed Standish, Ayer & Wood as its investment manager. Previously Chinook Capital Management handled fixed income investments and U.S. Bank handled equity investments. All investment activities are restricted by an investment policy and

SUBSEQUENT EVENTS (Continued)

control checklist. The policy and control checklist were reviewed and found to be in compliance with statutory requirements.

Effective January 1, 1998, the Company changed its reinsurance brokers from Sedgwick Re to Willis Faber North America, Inc.

In 1998, the Company approved the acquisition of an integrated computer system.

The retro reinsurance premium liability which was transferred from Northwest Healthcare Insurance Services on December 31, 1996 was returned to the parent company on December 31, 1997. No gain or loss was recorded on either transaction.

During May 1998, the Company's parent entered into negotiations to sell the building which the Company occupies. At this time, the negotiations include a minimum lease period of five years with one five year option to extend the Company's lease.

The Company currently participates in a self-insurance program with a public corporation, which is a political subdivision of the state of Oregon. Premiums collected under this program were approximately $2,500,000 for the year ended December 31, 1997, and were fully ceded to reinsurers. The ceded premium includes approximately $2,300,000, which was placed with an offshore captive of the public corporation. The Company currently has a letter of credit for ceded losses and unearned premiums placed with the offshore captive.

FINANCIAL STATEMENTS

The following statements reflect the financial condition of the Company as of December 31, 1996, as determined by this examination:

Balance Sheet
As of December 31, 1996

Statement of Income
Year Ended December 31, 1996

Capital and Surplus Account
As of December 31, 1996

Comparative Balance Sheet
As of December 31, 1995 and 1996

Comparative Statement of Income
For the Years Ended December 31, 1995 and 1996

Comparative Capital and Surplus Account
Years Ended December 31, 1992 through 1996

WASHINGTON CASUALTY COMPANY

BALANCE SHEET

AS OF DECEMBER 31, 1996

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	Notes
ASSETS				
Bonds	$35,131,293		$35,131,293	1
Common stocks	6,804,751		6,804,751	2
Cash on hand and on deposit	970,933		970,933	
Short-term investments	2,772,331		2,772,331	3
Agents' balances or uncollected premiums:				
Premiums in course of collection less ceded reinsurance	185,904		185,904	8
Reinsurance recoverable on loss & loss adj. expense pmts.	5,740		5,740	
Federal income tax recoverable				
Interest, dividends and real estate income due and accrued	477,657		477,657	
Receivable from parent, subsidiaries and affiliates	1,346,345		1,346,345	
Aggregate write-ins for other than invested assets	19,805		19,805	
Total Assets	$47,714,759		$47,714,759	
LIABILITIES				
Losses	$19,106,908		$19,106,908	5, 6
Loss adjustment expenses	9,279,114		9,279,114	5, 6
Other expenses (excluding taxes, licenses & fees)	603,035		603,035	
Taxes, licenses & fees (excl. fed. inc. tax)	71,530		71,530	
Fed. and foreign inc. taxes (excl. def. taxes)	493,102		493,102	
Unearned premiums	690,797		690,797	4
Amounts withheld by company for others	17,453		17,453	
Provision for reinsurance	342,000		342,000	6
Deposit Premium Payable	386,829		386,829	
Total liabilities	30,990,768		30,990,768	
SURPLUS AND OTHER FUNDS				
Common capital stock	1,500,000		1,500,000	
Gross paid in and contributed surplus	6,900,000		6,900,000	
Unassigned funds (surplus)	8,323,991		8,323,991	
Surplus as regards policyholders	16,723,991		16,723,991	
Total liabilities, surplus and other funds	$47,714,759		$47,714,759	

WASHINGTON CASUALTY COMPANY

STATEMENT OF INCOME

YEAR ENDED DECEMBER 31, 1996

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION	Notes
UNDERWRITING INCOME				
Premiums earned	$13,407,754		$13,407,754	4, 6
DEDUCTIONS:				
Losses incurred	9,454,014		9,454,014	
Loss expenses incurred	2,118,626		2,118,626	
Other underwriting expenses incurred	4,530,277		4,530,277	
Total underwriting deductions	16,102,917		16,102,917	
Net underwriting gain or (loss)	(2,695,163)		(2,695,163)	
INVESTMENT INCOME				
Net Investment Income earned	2,425,048		2,425,048	
Net realized capital gains or (losses)	1,384,618		1,384,618	
Net investment income gain or (loss)	3,809,666		3,809,666	
OTHER INCOME				
Miscellaneous income	45,590		45,590	
Total other income	45,590		45,590	
Net income before federal and foreign income taxes	1,160,093		1,160,093	
Federal and foreign income taxes incurred	422,659		422,659	7
Net income	$737,434		$737,434	
Surplus as regards policyholders, December 31, previous year	$16,622,789		$16,622,789	
GAINS AND (LOSSES) IN SURPLUS				
Net income	737,434		737,434	
Net unrealized capital gains or (losses)	(238,150)		(238,150)	
Change in non-admitted assets	(109,082)		(109,082)	
Change in provision for reinsurance	(289,000)		(289,000)	
Changes in surplus	101,202		101,202	
Surplus as regards policyholders, December 31, current year	$16,723,991		$16,723,991	

WASHINGTON CASUALTY COMPANY

COMPARATIVE BALANCE SHEET

AS OF DECEMBER 31,

	1996	1995
ASSETS		
Bonds	$35,131,293	$29,570,901
Common stocks	6,804,751	4,257,287
Cash on hand and on deposit	970,933	463,093
Short-term investments	2,772,331	6,442,809
Agents' balances or uncollected premiums:		
Premiums in course of collection less ceded reinsurance	185,904	514,164
Reinsurance recoverable on loss & loss adj. expense pmts.	5,740	11,807
Federal income tax recoverable		224,562
Interest, dividends and real estate income due and accrued	477,657	480,297
Receivable from parent, subsidiaries and affiliates	1,346,345	745,475
Aggregate write-ins for other than invested assets	19,805	449,599
Total Assets	$47,714,759	$43,159,994
LIABILITIES		
Losses	$19,106,908	$19,106,908
Loss adjustment expenses	9,279,114	9,279,114
Other expenses (excluding taxes, licenses & fees)	603,035	603,035
Taxes, licenses & fees (excl. fed. inc. tax)	71,530	71,530
Fed. and foreign inc. taxes (excl. def. taxes)	493,102	493,102
Unearned premiums	690,797	690,797
Amounts withheld by company for others	17,453	17,453
Provision for reinsurance	342,000	342,000
Deposit Premium Payable	386,829	386,829
Total liabilities	30,990,768	30,990,768
SURPLUS AND OTHER FUNDS		
Common capital stock	1,500,000	1,500,000
Gross paid in and contributed surplus	6,900,000	6,900,000
Unassigned funds (surplus)	8,323,991	8,323,991
Surplus as regards policyholders	16,723,991	16,723,991
Total liabilities, surplus and other funds	$47,714,759	$47,714,759

WASHINGTON CASUALTY COMPANY

COMPARATIVE CAPITAL AND SURPLUS ACCOUNT

AS OF DECEMBER 31,

	BALANCE PER COMPANY	EXAMINATION ADJUSTMENTS	BALANCE PER EXAMINATION
UNDERWRITING INCOME			
Premiums earned	$13,407,754		$13,407,754
DEDUCTIONS:			
Losses incurred	9,454,014		9,454,014
Loss expenses incurred	2,118,626		2,118,626
Other underwriting expenses incurred	4,530,277		4,530,277
Total underwriting deductions	16,102,917		16,102,917
Net underwriting gain or (loss)	(2,695,163)		(2,695,163)
INVESTMENT INCOME			
Net Investment Income earned	2,425,048		2,425,048
Net realized capital gains or (losses)	1,384,618		1,384,618
Net investment income gain or (loss)	3,809,666		3,809,666
OTHER INCOME			
Miscellaneous income	45,590		45,590
Total other income	45,590		45,590
Net income before federal and foreign income taxes	1,160,093		1,160,093
Federal and foreign income taxes incurred	422,659		422,659
Net income	$737,434		$737,434

	1996	1995	1994	1993	1992
Surplus as regards policyholders, December 31, previous year	$16,622,789	$15,813,136	$13,663,066	$10,224,178	$7,691,705
GAINS AND (LOSSES) IN SURPLUS					
Net income	737,434	632,652	2,656,747	3,421,635	1,117,154
Net unrealized capital gains or (losses)	(238,150)	193,577	(188,440)	(50,705)	73,978
Change in non-admitted assets	(109,082)	(41,576)	(272,237)	22,009	19,290
Change in provision for reinsurance	(289,000)	25,000	(46,000)	45,949	(77,949)
Surplus adjustments					1,400,000
Changes in surplus	101,202	809,653	2,150,070	3,438,888	2,532,473
Surplus as regards policyholders, December 31, current year	$16,723,991	$16,622,789	$15,813,136	$13,663,066	$10,224,178

NOTES AND COMMENTS TO FINANCIAL STATEMENTS

Accounting Policies and Basis of Presentation:

The statutory financial statements of the Company are prepared in conformity with accounting practices prescribed by the Insurance Commissioner's Office of the State of Washington.

Investments:

Bonds, common stocks, and short-term investments are stated at values prescribed by the National Association of Insurance Commissioners (NAIC), as follows:

1. Bonds are reported at amortized cost. The discount or premium on bonds is amortized using the effective-yield method.

   The Company's bonds were 100% rated class 1 or 2 by the Securities Valuation Office. As of December 31, 1996, the market value of investments in bonds equaled $35,238,071. Cost or amortized cost for these securities amounted to $35,131,292.

2. The Company's common stocks consist of investments in nine separate mutual funds. Common stocks are reported at market value as determined by the Securities Valuation Office of the NAIC. Unrealized gains and losses on investments in common stocks are reported directly in surplus and do not affect net income.

3. Short-term investments are reported at cost, which approximates market, and include investments with maturities of less than one year at the date of acquisition.

Realized investment gains and losses are determined using the specific-identification basis. Changes in admitted asset carrying values of common stocks are credited and charged directly to unassigned surplus.

No single investment exceeded 4% of assets as set forth in RCW 48.13.030 Limitation on securities of one entity.

Premiums:

4. All policies are written on a claims-made basis. Earned premiums are recognized using the pro rata method. Premiums collected in advance for tail coverage, if any, are reported as unearned.

Loss and Loss Adjustment Expense:

5. Loss and loss adjustment expense represents the estimated ultimate net cost of all reported and unreported losses incurred through December 31. The unpaid loss and loss adjustment expense is not discounted and is net of salvage and subrogation recoveries. These expenses are estimated using individual case-basis valuations and statistical analysis. These estimates are subject to the effects of trends in loss severity and frequency.

   The reserves carried by the Company for these liabilities were $19,106,908 and $9,279,114, respectively, as of December 31, 1996.

Reinsurance:

6. Reinsurance premiums, losses and loss adjustment expenses are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums; losses; loss adjustment expenses; and the reserves for losses, loss adjustment expenses, and unearned premiums are reported net of reinsured amounts.

Reinsurance ceded activity has reduced certain financial statement amounts as follows:

Premiums earned	$4,283,000
Loss and loss adjustment expense incurred	1,875,000
Loss and loss adjustment expense reserves	2,345,000

Liability for reinsurance balances has been provided for unsecured, unearned premiums and unpaid losses ceded to reinsurers not admitted to the state of Washington. The Company's Schedule F penalty amounted to $342,000 on December 31, 1996. The Company has had no disputed amounts due from reinsurers and no amounts determined to be uncollectible

Federal Income Taxes:

7. The Company and its Parent file a consolidated federal income tax return. Under a written agreement, the Company pays to or receives from its Parent the amount of tax expense or benefit determined as if the Company and the Parent filed separate returns.

Non-Admitted Assets:

8. Non-admitted assets consists of $36,612 of accounts due from policy holders which had any balances over 90 days due, and prepaid expenses and deferred acquisition costs of $445,661.

ACKNOWLEDGMENT

The cooperation extended to the examiners by the officers and employees of the Company during the course of this examination is hereby acknowledged.

In addition to Larry A. Omdal, Examiner in Charge, Insurance Examiners', Frank S. Ebreo, AFE, FLMI John R. Jacobson AFE and EDP Specialist, Timoteo L. Navaja, CFE and Field Coordinator, Actuary, Jim Antush, and Chief Property/Casualty Actuary, D. Lee Barclay, FCAS, MAAA, all from the Office of Insurance Commissioner, State of Washington, participated in the examination and preparation of this report.

State of Washington)
) ss
County of King)

Larry A. Omdal, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

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Larry A. Omdal
Examiner in Charge

Subscribed and sworn to before me on this 4th day of September, 1998.

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Notary Public in and for the

State of Washington,

residing at __________________________